No. 91-615

In the Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation, PETITIONER

v.

DIRECTOR, DIVISION OF TAXATION, RESPONDENT

On Writ of Certiorari to the Supreme Court of New Jersey

REPLY BRIEF OF PETITIONER

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INTRODUCTION

The central question in this case is whether there was a sufficient connection between Bendix's business activities in New Jersey and its investment in ASARCO to permit New Jersey to tax Bendix's gain from the sale of its ASARCO stock. Our opening brief argued that the requisite link was missing because, under established constitutional standards tracing back to the 19th century and recently applied by this Court in *ASARCO* and *Woolworth*, Bendix's passive investment in ASARCO could not be considered part of the unitary business that Bendix conducted in New Jersey.

New Jersey's response proceeds along two analytical paths. First, it characterizes Bendix's investment in ASARCO as part of Bendix's business activity in New Jersey on the theory that the investment served an "operational function" in Bendix's unitary business. N.J. Br. 26. Second, New Jersey seeks to undermine *ASARCO* and *Woolworth* and to distinguish them into oblivion. As we demonstrate below, New Jersey's characterization of Bendix's investment in ASARCO as "operational" cannot be squared with the undisputed facts of this case or with the line this Court has drawn between an "investment function" and an "operational function." *Container*, 463 U.S. at 180 n.19. Moreover, New Jersey's effort to distinguish *ASARCO* and *Woolworth* from the instant case is futile. Finally, the essentially contentless "rule" of law reflected in the decision below, and in the efforts of New Jersey and its amici to defend it, would eviscerate settled constitutional restraints on state taxation and create an utterly unworkable standard for adjudicating future controversies.

ARGUMENT

I. THERE IS NEITHER FACTUAL NOR LEGAL FOUNDATION FOR NEW JERSEY'S ASSERTION THAT BENDIX'S INVESTMENT IN ASARCO SERVED AN "OPERATIONAL" RATHER THAN AN "INVESTMENT" FUNCTION.

It is beyond dispute that Bendix and ASARCO were not engaged in a unitary business, a point New Jersey now explicitly concedes. N.J. Br. i. Consequently, Bendix's gain from the sale of its ASARCO stock is taxable by New Jersey only if the investment itself constituted part of Bendix's unitary business as carried on in part in New Jersey. But New Jersey does not contend—nor, in light of the record, could it contend—that Bendix employed the ASARCO stock in Bendix's day-to-day operations as working capital or as an asset serving an operational function under the *Corn Products* doctrine. Instead, New Jersey asserts that Bendix's investment in ASARCO served an operational function as part of Bendix's "strategy" to "diversify Bendix's overall operations" (N.J. Br. 25) and to "grow and become more profitable" (N.J. Br. 28). New Jersey also suggests, although almost as an afterthought, that Bendix's investment in ASARCO served an operational function because Bendix's "business operations . . . include the acquisition and sale of interests in other corporations." N.J. Br. 36. New Jersey's first argument fails as a matter of law to establish that Bendix's investment served an operational function, and the second is without support in the record.

A. New Jersey Errs In Asserting That Bendix's Investment In ASARCO, Because It Diversified Bendix's Operations And Contributed To Bendix's Profitability, Served An Operational Function.

Because Bendix's investment in ASARCO cannot be considered "operational" as that term has been employed by this Court, *Container*, 463 U.S. at 180 n.19, New Jersey is compelled to redefine the concept of an operational function in an effort to fashion a constitutional

predicate for taxing Bendix's gain from the sale of its ASARCO stock. New Jersey contends that the ASARCO investment served an operational function, and therefore was part of Bendix's unitary business, because the ASARCO investment diversified Bendix's range of activities, thereby "insulating the company's overall profitability from the cyclical downturns in its core operating areas and fostering the future growth of the company." N.J. Br. 25.

While New Jersey couches its argument in terms of the familiar unitary factors of "functional integration" and "centraliz[ed] . . . management," *Mobil*, 445 U.S. at 438; *Exxon*, 447 U.S. at 222, New Jersey's construct bears no resemblance to the unitary business concept delineated by this Court. That concept requires that the "out-of-state activities of the purported unitary business"—such as Bendix's activities in managing its investment in ASARCO—must "be related in some concrete way to the in-state activities"—such as Bendix's aerospace operations in New Jersey—"beyond the mere flow of funds arising out of a passive investment or a distinct business operation." *Container*, 463 U.S. at 166.

For purposes of this argument we accept New Jersey's contention (*e.g.*, N.J. Br. 32-33, 43-47) that intangible income can in some circumstances be part of a taxpayer's unitary business operations even though the business of the taxpayer and that of the company in which it has invested are not unitary. For example, interest paid by a bank on certificates of deposit in which a taxpayer has temporarily invested working capital would be apportionable income of the enterprise in which the taxpayer employs the working capital, even though the bank's business and the taxpayer's business are not unitary. But here New Jersey points to no such concrete link. Rather, it alleges "functional integration" between Bendix and its ASARCO investment because the investment served to: "diversify Bendix' overall operations" (N.J. Br. 25); "ensur[e] overall profitability" (*id.*); and "generate . . . capital" for future acquisitions (N.J. Br. 26). Nowhere

does New Jersey indicate *how* Bendix's investment in ASARCO affected Bendix's existing unitary operations in New Jersey. If ASARCO stock had gone down in value, thereby rendering Bendix's investment in ASARCO unprofitable, there is nothing in the record to suggest that this would have had any impact—much less a "concrete" impact—on Bendix's New Jersey operations, aside from the constitutionally irrelevant fact that Bendix would no longer derive as much "economic benefit . . . from its ownership of stock in another corporation." *Woolworth*, 458 U.S. at 364.

Indeed, New Jersey's position that "Bendix' use of the ASARCO sale proceeds in its attempt to acquire Martin Marietta . . . served an 'operational function'—the growth and profitability of one of Bendix' core businesses" (N.J. Br. 26) reveals just how far New Jersey would loosen the unitary business concept from its constitutional moorings. No longer would the "definite link" (*Miller Bros. v. Maryland*, 347 U.S. 340, 345 (1954)) between a non-domiciliary taxpayer's out-of-state investment and its in-state business activities be measured by a "concrete" connection between the two. Instead, a unitary link would be traced by drawing a line from the *subsequent* use of the proceeds back to the investment, even though the actual link between the investment and the taxpayer's business had been completely severed. This "stepping stone" (N.J. Br. 48) theory of a unitary business would stretch the concept beyond constitutional recognition, allowing states to apportion income from investments with which they have no meaningful connection merely because the proceeds from such investments were subsequently used to support the taxpayer's business operations in the state.

New Jersey's reliance on Bendix's alleged "strong centralized management" (N.J. Br. 28) as providing an operational link between Bendix's investment in ASARCO and its unitary New Jersey business activities is similarly misguided. First, there is nothing in any of the decisions below, or in the record, that would support the

claim that Bendix's management created a "flow of value" between Bendix's investment in ASARCO and its unitary operations conducted in part in New Jersey. In particular, since Bendix did not control ASARCO, it lacked the power to mobilize the income and assets of ASARCO to benefit Bendix's regular businesses. Unlike the normal countercyclical investment that could provide for a flow of funds when the primary line of business experiences a downturn, Bendix could obtain a flow of funds from ASARCO only if the independent ASARCO board of directors elected to declare a dividend.

Second, the "centralized management" of the ASARCO investment that allegedly linked that investment to Bendix's ongoing unitary operations (N.J. Br. 29-30) consisted simply of those minimal actions of a prudent investor necessary to acquire, oversee, and dispose of a passive investment. Those activities had nothing to do with the ordinary operation of Bendix's businesses in New Jersey. Thus, Bendix consulted outside experts and publicly available sources of information in evaluating the wisdom of the investment, Stip. ¶¶ 62, 64 (J.A. 165); Exh. D (J.A. 231-33); Exh. E (J.A. 95-100); Stip. ¶ 45 (J.A. 166-67); Exh. F (J.A. 127); it periodically reviewed the status of its investment, Stip. ¶¶ 57, 59-60 (J.A. 168-69); and, when the price of the investment rose and Bendix decided to reduce its investment in natural resource businesses, Bendix sold the investment. Stip. ¶ 58 (J.A. 169); Stip. ¶ 64 (J.A. 171). There is no suggestion that, in investing in ASARCO, Bendix ever relied on "the resources of information and expertise developed in its own . . . business," *ASARCO*, 458 U.S. at 337 (O'Connor, J., dissenting), or that the "inside" information that Bendix derived from having two of its directors sit on ASARCO's board of directors ever was or realistically could have been employed to further Bendix's unitary business operations conducted in part in New Jersey.

New Jersey's strained attempt to draw an analogy between this case and *Exxon* (N.J. Br. 28-30) reveals its fundamental misconception of the unitary business doc-

trine. In *Exxon*, this Court observed that a vertically integrated oil company—the quintessential unitary business—was a "highly integrated business which benefits from an umbrella of centralized management and controlled interaction." 447 U.S. at 224. Exxon's management took actions to coordinate the oil company's core business operations, including centralized purchasing, gasoline supply, and uniform packaging. *Id.* Because there was clearly a "flow of value" from Exxon's out-of-state production and refining operations to its in-state marketing operations, Wisconsin was entitled to include the income from all such operations in Exxon's apportionable tax base.

New Jersey argues that Bendix's income from its ASARCO investment, like Exxon's income from its integrated oil business, should be part of the taxpayer's apportionable tax base. But this argument completely loses sight of the underlying function of the unitary business principle, which is to confine the state's power to tax income from out-of-state activities to circumstances in which there is a "flow of value" between the in-state and out-of-state activities. The mere fact that Bendix's management in Southfield, Michigan oversaw the company's minority investment in ASARCO and analyzed it "from the point of view of Bendix' existing businesses and its effect on Bendix' future growth" (N.J. Br. 29) does not respond to the critical question whether the investment was related "in some concrete way" to Bendix's operations *in New Jersey*. What counts is whether the investment was actually employed to support *those* operations—whether as working capital, or as a hedge against price increases (as in *Corn Products*), or to secure a source of supply (as arguably was the case in *ASARCO*). Because the ASARCO investment was not so employed, it lacked the requisite "minimum connection" (*Miller Bros.*, 347 U.S. at 345) with Bendix's

unitary New Jersey business operations to enable New Jersey to tax the ASARCO gain.[1]

B. There Is No Record Support For The Assertion That Bendix Had An Operational Function Of Acquiring And Selling Interests In Other Corporations.

New Jersey and its amici never explicitly take issue with the fact that virtually all of the companies that Bendix acquired during the 1960s and 1970s were directly related to its preexisting lines of business. Allied-Signal Br. 5, 30. Nonetheless, in an effort to paint Bendix's profit from its ASARCO investment as arising out of the regular business operations that Bendix conducted in part in New Jersey, they utilize these acquisitions to ascribe to Bendix a business function of buying and selling interests in other corporations. N.J. Br. 36; Cal. Am.

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[1] The suggestions by New Jersey and its amici that Bendix was inconsistent in its treatment of the ASARCO investment in its tax returns (N.J. Br. 13-14; Cal. Am. Br. 23-25) lack substance. First, Bendix deducted the expenses associated with its acquisition of the ASARCO stock from its New Jersey apportionable tax base because that is what the statute required. N.J. Stat. Ann. § 54:10A-4 (Pet. App. 69a-71a). New Jersey law does not provide for the add back of expenses related to income not taxable by New Jersey. Second, Bendix's inclusion of its ASARCO dividends in its New Jersey returns appears to have been an oversight. As soon as this oversight was discovered, Bendix sought to exclude the ASARCO dividends from its New Jersey tax base for the same reasons that it sought to exclude the capital gain on its ASARCO stock from its tax base. See Complaint ¶ 3(G) (J.A. 11). However, Bendix subsequently discovered that its claim with respect to the dividends was barred by the statute of limitations; it thereupon amended its complaint in the New Jersey Tax Court to drop the claim. Third, Bendix's failure to exclude its investment in ASARCO from the net worth portion of New Jersey's corporation business tax was attributable to the fact that the amounts of tax involved were relatively small and Bendix never focused on the question. It clearly did not amount to a "concession" (N.J. Br. 14) that the ASARCO stock was apportionable for New Jersey tax purposes, and none of the three New Jersey courts through which this case has journeyed even suggested that any such concession might have been made.

Br. 20-21. The record belies this claim, which was not relied upon by any of the courts below in reaching their decisions.

First, it is beyond dispute that the overwhelmingly majority of Bendix's acquisitions were designed to strengthen or expand Bendix's existing operations and to enhance its product lines. Allied-Signal Br. 5, 30 & n.13; Stip. ¶¶ 128-153 (J.A. 183-92). There is nothing in the record to support the allegation that Bendix was also in the business of buying and selling interests in other corporations. Indeed, the stipulated facts are to the contrary. Stip. ¶ 11 (J.A. 154-55). Bendix's infrequent acquisitions (and subsequent dispositions) of interests in unrelated businesses hardly make investments in other corporations Bendix's stock in trade.

Second, in any event, Bendix's investment in ASARCO was so different from Bendix's investments in other corporations as to preclude characterization of the ASARCO investment as operational. Unlike virtually every other instance, which involved acquisition of a controlling interest in another company, Bendix's investment in ASARCO was a minority interest that gave it no control of ASARCO. Similarly, Bendix's investment in ASARCO was (in William Agee's words) "different" because "[i]t was a nonoperating situation." J.A. 28-30. This meant, among other things, that Bendix could not control the direction taken by ASARCO's business or the flow of dividends in order to harmonize them with Bendix's own operational needs.

Third, even if Bendix were viewed as having had an investment business that included the acquisition, oversight, and management of stock in ASARCO, nothing in the record would support the conclusion that any such investment business was unitary with the businesses that Bendix was conducting in part in New Jersey or that the investment business itself was carried on in New Jersey.

In short, under any theory heretofore recognized by this Court, Bendix's investment in ASARCO cannot be characterized as serving an "operational function." *Con-*

tainer, 463 U.S. at 180 n.19. It served purely an "investment function" (*id.*), the income from which, under *ASARCO* and *Woolworth*, is not taxable by a nondomiciliary state.

II. THIS CASE CANNOT BE MEANINGFULLY DISTINGUISHED FROM *ASARCO* AND *WOOLWORTH*, WHICH REFLECT SOUND AND SETTLED PRINCIPLES OF CONSTITUTIONAL ADJUDICATION THAT SHOULD NOT BE DISTURBED.

As our opening brief demonstrated, *ASARCO* and *Woolworth* unequivocally rejected the very theory underlying New Jersey's case, namely, that income from intangibles should be considered part of a unitary business whenever the investments serve long-range corporate interests to increase prosperity, add to the company's capital base, and strengthen its overall ability to achieve operational growth or diversification. "This definition of unitary business," the Court declared, "would destroy the concept." *ASARCO*, 458 U.S. at 326. We also showed that the facts here present an even stronger case for holding the taxpayer's investment nonunitary than did the facts of *ASARCO* and *Woolworth*. Allied-Signal Br. 31-34, 1a-4a.

New Jersey and its amici recognize that their position is difficult, if not impossible, to reconcile with *ASARCO* and *Woolworth*. New Jersey seeks to discredit these precedents by asserting that they "are not consistent with the Court's earlier unitary business decisions" (N.J. Br. 23), although it does not call for their overruling but rather purports to distinguish *ASARCO* and *Woolworth* on their facts (N.J. Br. 38-41). With considerably more candor, California and its sister amici directly urge this Court to overturn *ASARCO* and *Woolworth* on the ground that the Court "rejected too hastily 'corporate purpose' as the test," and that "'corporate purpose,' correctly defined, is the proper standard for determining apportionability." Cal. Am. Br. 20 (emphasis omitted).[2]

[2] Whatever the merit of California's suggestion, and we submit it has none, the Court should not consider overruling *ASARCO* and

But *ASARCO* and *Woolworth* reflect long-standing and well-considered principles of constitutional adjudication that strike the proper balance between the conflicting interests of taxing states and multistate enterprises, to wit, the states' claim for a fair share of revenue derived from activities carried on within their borders and multistate taxpayers' claim for protection from taxes on income from out-of-state activities having no substantial connection with the taxing state. The accommodation between these competing concerns has been reached over more than a century of litigation (Allied-Signal Br. 19 n.9), and the particular balance struck in *ASARCO* and *Woolworth* and reaffirmed in *Container* faithfully implemented the established constitutional norms.

The groundwork for the line that the Court drew in *ASARCO* and *Woolworth*—between income from out-of-state activities that have a concrete operational connection to the taxpayer's activities in the taxing state and income from out-of-state activities that merely add to the overall riches of the corporation—was laid over half a century earlier in *Wallace* v. *Hines*, 253 U.S. 66, 69-70 (1920) (quoted in *ASARCO*, 458 U.S. at 328, and in *Woolworth*, 458 U.S. at 363). Indeed, the Court had reemphasized this line just two years before *ASARCO* and *Woolworth* in *Mobil*, where it observed that a non-domiciliary state lacks power to tax income from intangibles when "the income was earned in the course of activities unrelated to" the underlying operations of the taxpayer in the state. 445 U.S. at 439. The fundamental principle on which all these cases rest, one that is deeply rooted in this Court's constitutional jurisprudence, is that, in the absence of a substantial connection between income generated from out-of-state activities and the tax-

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Woolworth in this case. The Court ordinarily will not consider arguments advanced only by amici (see, *e.g.*, *Kamen* v. *Kemper Financial Services, Inc.*, 111 S. Ct. 1711, 1717 n.4 (1991); *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 761-762 n.7 (1984); *United Parcel Service, Inc.* v. *Mitchell*, 451 U.S. 56, 60 n.2 (1981)), and this principle is especially apt when what amici propose is the overruling of this Court's precedents.

payer's operations in the state, the state has not "given anything for which it can ask return." *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444 (1940) (quoted in *ASARCO*, 458 U.S. at 328; see also *Woolworth*, 458 U.S. at 372).

Other than its distaste for adverse precedent, New Jersey has offered no cogent reason why these well-considered decisions should be disturbed. New Jersey's contention that *ASARCO* and *Woolworth* should not be read to limit the apportionability of income from intangibles to payments from a payor to a unitary payee (N.J. Br. 43-47), makes no difference in this case because there is *no* theory upon which the apportionability of Bendix's income from its investment in ASARCO can plausibly be based.[3]

New Jersey's effort to distinguish *ASARCO* and *Woolworth* on their facts (N.J. Br. 38-41) is wholly unpersuasive. As we have shown, this is a far stronger case for holding the taxpayer's investment nonunitary than

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[3] Consequently, New Jersey's citation to academic authorities who have suggested that the payor-payee test of apportionability ought not be exclusive, and that income from temporary investments of working capital should be apportionable, is beside the point. N.J. Br. 35, 39. Moreover, those very authorities actually support Bendix's position in this case. In commenting on an earlier New Jersey decision, *Silent Hoist & Crane Co.* v. *Director, Division of Taxation*, 494 A.2d 775 (N.J.), cert. denied, 474 U.S. 995 (1985), which, like the decision below, sustained the apportionability of intangible income from out-of-state investment activities that had no operational connection to the taxpayer's New Jersey business activities, they observed:

> Treating such operationally independent businesses as unitary invariably distorts and misattributes income that belongs to one State or another. *Put in terms of the fundamental basis for taxation of corporations, New Jersey provided no protections or benefits to the investment activities, and it incurred no social costs on their account.*

J. Hellerstein & W. Hellerstein, *1989 Cumulative Supplement* S228 to J. Hellerstein, *State Taxation* (1983) (emphasis supplied). In holding Bendix's income apportionable, the court below relied on its dubious decision in *Silent Hoist & Crane*. Pet. App. 14a, 20a.

was either *ASARCO* or *Woolworth*. See Allied-Signal Br. 31-34, 1a-4a. And New Jersey's suggestion that Idaho had conceded that a unitary business relationship between payor and payee was a *sine qua non* of apportionability (N.J. Br. 41) is indefensible in light of the Court's rejection of Idaho's "corporate purpose" argument based on quotations from Idaho's brief and from oral argument. *ASARCO*, 458 U.S. at 325-326.

Finally, New Jersey's claim that *ASARCO* and *Woolworth* are distinguishable because the records in those cases did not support the "corporate strategy" argument that New Jersey now advances is both wrong and irrelevant. It is wrong because ample evidence in the *ASARCO* record showed, for example, that ASARCO's investment in Southern Peru was motivated by an "operational strategy" to secure a source of supply and was based on management expertise in the copper industry. *ASARCO*, 458 U.S. at 320-322; *id.* at 335-337 (O'Connor, J., dissenting). The Court nevertheless found no sufficient operational connection.

Moreover, the argument based on the records of those cases is irrelevant because the Court rejected the states' "corporate purpose" and "adds to the riches of the corporation" arguments as a matter of law, not as a matter of fact. *ASARCO*, 458 U.S. at 326; *Woolworth*, 458 U.S. at 363-64. Whatever ASARCO's purpose may have been, and however significant Woolworth's investments in its subsidiaries may have been to the overall economic stability of the parent, those facts were of no consequence in light of the controlling legal standard—a concrete relationship between in-state operations and out-of-state investments.

III. THE RULE OF LAW IMPLICIT IN THE DECISION BELOW IS UTTERLY UNWORKABLE, EFFECTIVELY JETTISONS ALL CONSTITUTIONAL RESTRAINTS ON STATE TAXATION OF INCOME FROM INTANGIBLES, AND SUBJECTS MULTISTATE BUSINESSES TO INCREASED RISK OF MULTIPLE TAXATION.

The pernicious effect of the decision below is not limited to the fact that it would radically revise the settled understanding of constitutional restraints on state tax power that has existed for decades. It also would create an unmanageable rule of law that would make it impossible to tell whether intangible income from passive investments is apportionable. As a consequence, it would spawn inconsistent treatment of the same transaction by different states, thereby subjecting multistate businesses to an unnecessary and unacceptable risk of multiple taxation.

The unworkable nature of a unitary business definition rooted in "corporate strategy" is well illustrated by New Jersey's attempt to apply it in this case. Under such a definition, so long as a corporation has articulated reasons for acquiring or disposing of an investment, it will have proclaimed a corporate strategy sufficient to render income from that investment apportionable. For example, where Bendix invested in a *related* business such as Martin Marietta, the investment is said to be unitary because it served the corporate strategy of expanding Bendix's existing businesses. N.J. Br. 26. Conversely, under New Jersey's "heads-I-win-tails-you-lose" formulation, Bendix's investment in an *unrelated* business such as ASARCO is said to be unitary because it furthered the announced corporate goal of diversification, protecting Bendix from cyclical downturns in its core businesses. N.J. Br. 6, 25, 29, 42. Along the same lines, the acquisition of *controlling* interests in other enterprises is said to be unitary because it enhanced Bendix's position in its core businesses. N.J. Br. 32. Yet acquiring a *minority* interest in ASARCO is likewise claimed to be unitary because Bendix "reaped additional advantages": "From an operational standpoint, the relatively smaller position

created less exposure to the cyclicality of ASARCO's earnings." N.J. Br. 31. Needless to say, when these earnings were viewed as countercyclical to those in Bendix's core businesses, they are also claimed to serve a unitary purpose, namely, diversification.

And, if there remained any possibility that some of Bendix's investment income might somehow escape apportionment, New Jersey removes it by observing that even the goal of making money would constitute a unitary corporate strategy. Thus, Bendix's investment in ASARCO is claimed to be "essential to the financial management of Bendix' unitary business" because "[o]ne purpose in acquiring what was essentially a large supply of copper was to position Bendix to benefit from an anticipated increase in the world price of copper." N.J. Br. 28. Similarly, one of the roles of top management is claimed to be "the continuous identification of investment opportunities in order to maximize stockholder return from a portfolio of investments." N.J. Br. 37.

If this Court were to embrace the standardless unitary business concept adopted by the court below and defended here by New Jersey and its amici, the law in this area would be left in shambles and multistate businesses would be exposed to uncertain and duplicative tax liabilities. The established and workable constitutional regime reflected in *ASARCO* and *Woolworth* would be replaced by an uncertain and arbitrary regime in which a state's power to tax a corporation would expand (in domiciliary states that benefit from apportionment) or contract (in nondomiciliary states that benefit from allocation) with each annual corporate report or news release. As a practical matter, the "corporate strategy" doctrine would permit nondomiciliary states to sweep virtually all of a taxpayer's investment income into the apportionable tax base on the theory that the investment served the "operational" goals of corporate growth and diversification. At the same time, however, because the "corporate strategy" doctrine is so bereft of meaningful content, domiciliary states could apply it to justify the allocation of the same invest-

ment income to the taxpayer's commercial domicile on the theory that the investment was not part of some "operational" strategy.

Adoption of New Jersey's malleable "test" of apportionability of investment income would therefore dramatically increase the risk that multistate taxpayers would be subjected to duplicative taxation resulting from inconsistent determinations of the apportionability of investment income. State taxing authorities seeking to maximize tax revenues would naturally seek to characterize investment income as allocable or apportionable depending on whether a particular taxpayer was a domiciliary or a nondomiciliary. Under New Jersey's contentless definition of a unitary investment, the taxpayer could not carry its burden of proof to show that either characterization was wrong. While this Court has tolerated some duplicative taxation arising from different state statutory division-of-income methods, *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978), there is no warrant for it to adopt, as a federal constitutional principle, a rule that not only is wholly unmanageable but also unnecessarily exposes interstate businesses to increased risks of multiple taxation.

Moreover, contrary to the suggestions of New Jersey and its amici, the current regime of state taxation of investment income that New Jersey seeks to displace is both workable and fair. The line that this Court has drawn between capital transactions serving an "operational function" and those serving an "investment function" is well established. *Container*, 463 U.S. at 180 n. 19; cf. *Corn Products*, 350 U.S. at 50-53. Under this regime, which is embodied in most states' statutes, investment income that is not operational and therefore may not be apportioned among the states in which a taxpayer does business is allocated in full to the taxpayer's commercial domicile. See Uniform Division of Income for Tax Purposes Act §§ 1(a), 1(e), 6(c), 7, 7A Uniform Laws Annotated 331 (1985); 1 Multistate Corporate Income Tax Guide (CCH) ¶ 145 (1991); *ASARCO*, 458

U.S. at 310-311. The consequence of this Court's decisions restraining nondomiciliary states' power to classify passive investment income as apportionable is simply to permit such income to be taxed by the state of the corporation's commercial domicile, where the investment is ordinarily managed.[4]

Finally, if a sea change is to be made in the law governing state taxation of intangible income earned by multistate enterprises, Congress, not this Court, should make it. Unlike the Court, which has expressed doubts over its institutional competence and constitutional authority to prescribe uniform allocation and apportionment rules, *Moorman*, 437 U.S. at 279-280, Congress has both. Congress is well equipped to weigh the competing considerations that ought to inform the choice of a sound division-of-income rule. Indeed, as Justice Frankfurter once observed, "Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting).

Moreover, this Court has left no doubt that Congress has the requisite power to implement its policy choices in this domain. "It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." *Moorman*, 437 U.S. at 280. While

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[4] Although Michigan, Bendix's domiciliary state, taxed only an apportioned share of Bendix's investment income, Michigan's value-added taxing scheme bears no resemblance to the typical net income tax imposed by most states. See *Trinova Corp.* v. *Michigan Dep't of Treasury*, 111 S. Ct. 818 (1991). If Bendix had been domiciled in a state other than Michigan, including most of the states that have joined the amicus briefs supporting New Jersey, Bendix's income from its sale of ASARCO would have been taxable in full in its state of domicile.

the constitutional restraints at issue here rest on the Due Process Clause as well as the Commerce Clause, that would not limit the power of Congress to act, at least in matters involving state taxation of interstate commerce. See Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387, 400-401 (1983) (Congress can consent to state laws where constitutional restrictions bind the States but not Congress); Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993, 1022-1028 (1986) (Congress can free the States from due process clause nexus restrictions in regulating state taxation of interstate commerce).

IV. ANY DRASTIC CHANGE IN THE LAW SHOULD BE MADE PROSPECTIVE ONLY.

We appreciate that this Court is divided on the question whether judicial decisions embodying newly announced principles of law may properly be confined to prospective application. For the reasons we have given, we submit that the decision of the New Jersey Supreme Court cannot be upheld except by breaking sharply with the line of authority that culminated in *ASARCO* and *Woolworth*, which represents relatively settled constitutional doctrine. Should the Court accept amici's invitation to take such a drastic step, despite our showing that there is neither a sound theoretical basis nor a demonstrable practical need for such action, its decision will give rise to the question whether the new rule must be given retroactive application to this and other similar cases.

We urge the Court to direct that any such basic change be effective only prospectively, applying solely to tax years commencing after the date of the decision in this case. It is not merely that *ASARCO* and *Woolworth*, by enunciating fundamental principles governing the taxation of multistate enterprises, sent forth to the business and industrial community unmistakable signals concerning constitutionally acceptable state taxing patterns. In

addition, countless tax returns have been prepared and filed throughout the nation in justifiable reliance on the principles enunciated. Some of these returns would still be open to review and revision; others would not. Elemental considerations of fairness, as well as the strong need for uniformity, counsel against disrupting such a vast array of transactions. See *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 106-108 (1971); *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969).

CONCLUSION

For the reasons set forth in our opening brief and in this reply brief, the judgment of the Supreme Court of New Jersey should be reversed with instructions to exclude Bendix's gain from the sale of its ASARCO stock from Bendix's apportionable tax base.

Respectfully submitted,

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